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June 10, 2011

VIA ELECTRONIC FILING

Ms. Cynthia T. Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, S.W., Room 1034
Washington, DC 20423-0001

Re: **STB Ex Parte No. 705**
Notice of Intent to Participate

Dear Ms. Brown:

The American Short Line and Regional Railroad Association ("ASLRRA"), which this firm represents as counsel, files this Notice of Intent to participate in the hearing in this proceeding to be held on June 22, 2011. The following individuals will testify on behalf of ASLRRA: Richard F. Timmons, President of ASLRRA; Michael Ogborn, Chairman of ASLRRA; Sharon Clark, Vice President – Transportation, Perdue AgriBusiness, Inc.; and Carl Martland, Senior Research Associate and Lecturer (retired), Massachusetts Institute of Technology.

ASLRRA respectfully requests forty-five minutes for its presentation. Attached please find the Testimony of all four persons who will testify on behalf of ASLRRA.

Very truly yours,

Myles L. Tobin
Attorney for the American Short Line and
Regional Railroad Association

MLT/ekf
Attachments (4)
cc: Richard F. Timmons, President, ASLRRA
Michael Ogborn, Chairman, ASLRRA
Sharon Clark, Vice President – Transportation, Perdue AgriBusiness, Inc.
Carl Martland, Senior Research Associate (Retired) MIT

BEFORE THE
SURFACE TRANSPORTATION BOARD

COMPETITION IN THE RAILROAD INDUSTRY	)	Docket No. EP 705

TESTIMONY OF RICHARD F. TIMMONS, PRESIDENT, AMERICAN SHORT LINE AND REGIONAL RAILROAD ASSOCIATION

TESTIMONY OF MICHAEL OGBORN, CHAIRMAN, AMERICAN SHORT LINE AND REGIONAL RAILROAD ASSOCIATION AND MANAGING DIRECTOR, OMNITRAX, INC.

TESTIMONY OF SHARON CLARK, VICE PRESIDENT – TRANSPORTATION PERDUE AGRIBUSINESS, INC.

TESTIMONY OF CARL MARTLAND, SENIOR RESEARCH ASSOCIATE AND LECTURER (RETIRED), MASSACHUSETTS INSTITUTE OF TECHNOLOGY

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**ATTORNEYS FOR
THE AMERICAN SHORT LINE AND
REGIONAL RAILROAD ASSOCIATION**

Dated: June 10, 2011

BEFORE THE
SURFACE TRANSPORTATION BOARD

COMPETITION IN THE RAILROAD INDUSTRY	)	Docket No. EP 705

TESTIMONY OF RICHARD F. TIMMONS, PRESIDENT, AMERICAN SHORT LINE AND REGIONAL RAILROAD ASSOCIATION

I am Richard Timmons, President of the American Short Line and Regional Railroad Association. ASLRRA is a national trade organization of 1,100 members consisting of 550 Class II and Class III railroads, most of which are small and locally based, as well as 550 vendors and suppliers to the small railroad industry. On behalf of our members, I thank the Board for inviting testimony on the current state of competition in the railroad industry.

Today's small railroad industry is largely the product of deregulatory initiatives launched by the 1980 Staggers Act, which was motivated in part by the Federal Government's determination that it was better to save light density branch lines than to abandon them. Since the passage of the Staggers Act, almost 300 newly formed railroads have acquired light-density rail lines. The rail lines serve customers and communities all across the United States. Many small railroad properties suffered from years of deferred maintenance and service deterioration by their previous owners and were candidates for abandonment. Entrepreneurs acquired these properties, rehabilitated the track infrastructure, hired and trained staff, and revitalized service in communities that faced loss of rail service, largely in rural areas of the country.

Today, these 550 small businesses - with median annual revenues of just $2.5 million - operate approximately 32 percent of the nation's rail lines, provide competitive service to more than 11,800 rail dependent employers, and play a critical role in the economy of the communities those carriers serve.

Small railroads have grown from 8,000 miles of track in 1980 to approximately 50,000 miles of track today. Small railroads have, in many instances, become the competitive solution to the consolidation of the Class I railroad industry over the course of the last several decades. Of equal importance, these small, local railroads have kept huge areas of the country connected to the national rail network, particularly in rural areas and small towns. In 30 states these small railroads operate more than 25% of the state's rail network. Absent this locally based service, thousands of shippers would have to move their products by truck or relocate to facilities on a Class I railroad. These same small railroads account for tens of thousands of jobs, both with the railroads themselves and the shippers and receivers which they serve.

Despite operating approximately 32 percent of the nation's rail system and participating in approximately 40 percent of all carload movements, small railroads earn barely five percent of national freight revenues. Similarly, small railroad operations are limited in scope. The average small railroad operates 99 route miles of rail lines and handles approximately 14,000 carloads of traffic per year. To put these numbers in perspective, the *smallest* of the seven Class I railroads operates 3,076 miles of rail line and handles 361,695 carloads of traffic per year.

The nation's small railroads transport their customers' traffic over relatively short distances to interchanges with Class I connections. Their traffic densities are light and their fixed costs are high. The extensive capital necessary to maintain and upgrade rail infrastructure is a significant drain on freight revenue resources. From the perspective of a small railroad, competition for business is fierce. The small railroads are in the trenches where we compete daily, carload by carload, with trucks and in some areas of the country with barges. Intramodal and intermodal competition is intense, and railroads struggle on a daily basis to maintain and grow their traffic base. Small railroads' rates are constrained by their competition and they rarely, if ever, have rate flexibility. Market power, let alone market abuse, is not in the lexicon of the small railroads.

Small railroads generally must compete for the "first or last mile" of the shipment with trucks and waterways as well as intermodal operators and rail-truck transload operations located on Class I's. Small railroads, by definition, operate trackage in close proximity to Class I carriers. Because the small railroads generally account for only a small portion of the mileage of any interline move, shippers frequently have an opportunity to bypass a small railroad by trucking their cargo to the nearest transload facility on a Class I rail system. Shippers can also bypass the small railroads by trucking intermodal shipments that move onto rails to intermodal facilities operated by a Class I carrier. Intermodal and transload facilities on Class I railroads often draw significant volumes of traffic away from the smaller railroads. These options make small railroads susceptible to traffic diversion in ways that generally do not affect Class I carriers. This extensive intermodal and intramodal competition faced by the small railroads on a daily basis has intensified over the last two decades.

Thus, despite the Board's view that the "Industry" is in substantially stronger condition financially than it was in 1980, the fact is that many of the small railroads continue to be faced with a day-to-day struggle to compete, cover fixed costs and infrastructure investment, and serve their customers. They do not have market power, and one cannot abuse what one does not have.

The small railroads' rail lines are highly concentrated in the sense that relatively few customers account for the vast majority of traffic on their line segments. It is not unusual for three or four customers to account for two-thirds of the rail traffic shipped by a small railroad. Loss of all or a portion of the revenues from any one of those shippers can have a dramatically adverse effect on the financial viability of the small carriers in view of the high infrastructure and fixed costs which must be supported by those revenues. Eliminating or reducing those revenues through a prescribed short-haul for the benefit of one shipper would, therefore, have a cascading effect which would

directly and adversely impact all shippers on the rail line. By the same token, permitting the Class I railroads to "cherry-pick" the small railroads' largest customers, through the artifice of forced terminal trackage rights or reciprocal switching, would wholly undermine the small railroads ability to serve the balance of their customers. Unlike the Class I railroads, the small railroads cannot spread their fixed costs over a vast rail system or large customer base. All of the freight revenues generated by customers on a small rail line are vitally necessary to sustain the financial viability of that line. For this Board to depart from the traditional regulatory model, and ignore the small railroads' absence of market power and their inability to abuse market power that they do not possess, serves no valid purpose, and could have the very real effect of undermining the financial viability of many small railroads.

A restructuring of the current regulatory landscape in a manner that reduces the small railroads' ability to serve their customers or to generate revenues sufficient to meet their high fixed and variable costs would cause substantial and irreparable harm, not only to these railroads but also to the multitude of communities, employees, and significant industries they serve. Changes to the current regulatory regime would (1) cause the departure from the marketplace of numerous existing smaller railroads, which would find their financial viability unsustainable in the face of increased regulation, and (2) stifle the ability of new short line and regional railroads to enter the transportation market as competitive rail alternatives for shippers.

The ASLRRA does not believe that changes to the current regulatory structure concerning the nation's rail industry would serve any valid or justifiable purpose. It is the industry's view that the STB should retain the regulatory structure which has promoted the development of a viable and sustainable national rail network, in general, and the small railroads in particular. If, however, the Board should decide that some changes to the regulatory regime are indeed necessary, the ASLRRA specifically requests that the STB fashion any such changes so that the customers,

communities, employees of the small railroads, and the small railroads themselves, are not adversely harmed. The financial viability of these small, locally based railroads and their ability to serve their customers are literally at stake.

I appreciate the opportunity to present the views of the small railroad industry on these important issues and I would be pleased to answer any questions you might have.

BEFORE THE
SURFACE TRANSPORTATION BOARD

COMPETITION IN THE RAILROAD INDUSTRY	)	Docket No. EP 705

**TESTIMONY OF MICHAEL OGBORN,
CHAIRMAN, AMERICAN SHORT LINE AND
REGIONAL RAILROAD ASSOCIATION AND
MANAGING DIRECTOR, OMNITRAX, INC.**

I am Michael Ogborn, Chairman of the American Short Line and Regional Railroad Association and Managing Director of OmniTRAX, Inc. I was appointed by the Chairman of the Surface Transportation Board to serve as one of four short line voting members of the Rail-Shipper Transportation Advisory Council ("RSTAC") and I serve on the Union Pacific Short Line Advisory Group as chair. I also am a member of the Rail Industry Working Group, a committee of Class I and smaller railroad representatives formed to, in part, maintain and facilitate communications between Class I railroads and smaller railroads and to monitor activities under the Rail Industry Agreement executed in 1998 by the Association of American Railroads and ASLRRA.

As the Managing Director of OmniTRAX, Inc., I am one of the senior leadership team members, primarily responsible for government relations and public relations for OmniTRAX and the railroad, terminal, and transportation companies which OmniTRAX manages. I serve on the acquisitions team, am the senior advisor on labor relations matters, and am on the negotiating team for the purchase and sale agreements of acquisitions or dispositions.

I would like to thank the Board for giving me the opportunity to speak on the important issues presented in this proceeding. I am here today to speak on behalf of the "little guys" – the 550 small business entrepreneurs who, collectively, comprise the short line and

regional railroad industry. These small railroads, with an average of 28 employees and 99 miles of track, provide competitive service to more than 11,800 customers nationwide.

I speak to you today as one of those entrepreneurs who, as Mr. Timmons aptly said, is in the trenches on a daily basis. We compete head to head with trucks, with barges, with nearby transload facilities, with intermodal facilities, and with the Class I's themselves, all of whom can easily divert traffic away from us if we are not service competitive and sufficiently flexible in our operating philosophy that we can take trucks off the road and keep them off the road. I can tell you from my own day-to-day experience that we do not have market power, we cannot abuse market power that we do not possess, and the "one size fits all" notion suggested to the Board by the proponents of regulatory change does not work for the small railroad industry.

I am here today speaking on behalf of small railroads, including the following entrepreneurs who used initiative and innovation to build their railroad's and their customers' businesses:

- The Northern Plains Railroad which, through significant infrastructure investment, helped to establish a wind component handling facility in Devil's Lake, North Dakota as part of the nation's growing wind-energy industry.
- The Greenville & Western Railway, which has grown from 100 annual carloads and two full-time and two part-time employees at start-up, to 1,872 carloads and eight full-time employees just three years later. It did this by working with an ethanol facility on its line, marketing that facility itself nationwide, and being willing to provide multiple daily switches to handle single car shipments until the customer built a unit train facility in order to grow the business. As Greenville &

Western's President says, "We value even one car, if you want to ship a single car with us, we'll find a way."

- The Finger Lakes Railway which, in conjunction with its Class I interchange partners, worked to create door-to-door industrial rebar service in Auburn, New York using an untapped fixed divisions agreement to penetrate the NAFTA Toronto marketplace and defeat truck competition.
- The Providence & Worcester, which constructed over a mile of track and acquired 160 new rail cars to capture materials transported to the New York City-Long Island-Area concrete and asphalt plants that typically move via trucks, ships and barges. In 2010 alone, over 5,000 rail carloads were diverted from those trucks, ships and barges. All of this traffic is obviously susceptible to diversion to truck and would be, but for the service provided by this railroad.
- The R.J. Corman/Central Kentucky lines which purchased locomotives, cars and hired 17 new employees to load and unload aluminum ingots moving from Berea, Kentucky to Russellville, Kentucky. R.J. Corman was able to meet the customer's requirement for delivering at least 60 ingots every two days. The rail operation has moved approximately 550 million pounds of aluminum ingots from Berea to Russellville on an annual basis, helping to divert approximately 11,000 trucks from Kentucky highways.
- The Pacific Harbor Line, which began operations in 1998 serving the twin ports of Los Angeles and Long Beach with switching services performed on 75 miles of track. Pacific Harbor Line serves nine on-dock intermodal terminals which, 20 years ago, port representatives called "unnecessary," as well as numerous carload

customers. As its traffic increased, it became focused on methodologies for reducing locomotive air pollution in California. The Pacific Harbor Line partnered with government agencies to expend over $30 million dollars for replacement of its entire locomotive fleet. Today, Pacific Harbor Line operates a one hundred percent EPA-compliant fleet of Tier II and Tier III "low" and "ultra-low" emission locomotives that has led the way for the port complex to reduce emissions by roughly 50 percent. Only about five percent of all U.S. railroad equipment achieves that level.

- The Wisconsin & Southern, which, through service and price flexibility, investment in track infrastructure, and acquisition of equipment, has added new customers and grown its customer base by approximately 20 percent, even in the face of a recession.
- The Twin Cities & Western Railroad Company that was once characterized as an "almost dead railroad." This small railroad has blossomed into an active and important part of the Minnesota economy through innovative marketing and operating practices that have provided container back-hauls for movement to its Class I interchange partners. Through these practices, the railroad has more than doubled its rail volume in the last decade and has opened up international markets for Minneapolis-St. Paul area grain movements in containers which previously were returned empty.
- The Great Western Railway of Colorado, which built trackage and connecting spurs to a new industrial park in Windsor, Colorado and then went out and

attracted a wind blade manufacturing plant, a bottling plant, and an ethanol facility, which in, turn produced over 2,000 new jobs in northern Colorado.

- The Rochester & Southern Railroad, with two large customers making up over two thirds of its traffic and revenue, but which provides service to thirty or so additional small customers. It is in close proximity to a Class I transload facility, and virtually all of its shipments could move via truck, but for the service and price flexibility provided by the Rochester & Southern.

Competition from trucks and other modes of transportation, however, could easily divert the traffic these small railroads have worked hard to develop. For example, the Finger Lakes traffic is particularly susceptible to diversion back to truck. The traffic of the Rochester & Southern's two large customers could certainly be diverted to the nearby Class I transload facility. Similarly, the traffic developed by the Great Western could be "cherry-picked" by another railroad as there are two railroads in close proximity that could, through the so-called terminal access provisions championed by some parties, take this traffic, leaving Great Western to serve a very small shipper producing little revenue.

The railroads I just mentioned are but a few of the 550 examples of small railroad businesses that continue to be faced with a day-to-day struggle to compete, cover fixed costs and infrastructure investment, and provide nimble service so that we can take trucks off the road and keep trucks off the road.

The proponents of regulatory change who have filed comments in this proceeding have barely even mentioned the small railroad industry. In the hundreds of comments filed, only two customers, both large chemical shippers, had anything remotely adverse to say about small

railroads and those brief comments were limited to concerns about special handling charges for extremely hazardous commodities.

We respectfully submit that those proponents of significant regulatory changes, many of whom, individually, have market capitalization values and annual revenues well in excess of the entire small railroad industry, threaten to undo all of the benefits provided by small railroads to the shipping public which have resulted from a post-Staggers era of decreased regulation, if their views are adopted by this Board. Proponents of turning back the "regulatory clock" would have this Board reduce the revenues of the small railroads through increased rate and/or access regulations. This would have the very real effect of eliminating the very service which those proponents would ask the Board to regulate more intensely.

Proponents of dramatic regulatory changes are urging this Board to soften the current regulatory requirement that through rate prescription be available only upon a showing of anti-competitive conduct, through an abuse of market power. We urge that requiring a showing of anti-competitive conduct is the correct standard and must be maintained. As we discussed throughout our initial and reply comments, it is not unusual for only a few customers to account for the vast majority of rail traffic and revenues generated by a small railroad. Eliminating or reducing those revenues through a prescribed short-haul for the benefit of one shipper would have a ripple effect which would adversely impact all shippers on the small railroad line. Small railroads have high infrastructure and fixed costs which must be supported by those revenues. The small railroads' costs cannot be spread over a vast rail system or a large customer base, and all of the freight revenues generated by customers on the small railroad are critical to sustaining the financial viability of the railroad. For this Board to depart from the traditional regulatory model, and ignore the fact that small railroads do not have market power and cannot abuse power

which they do not possess, in a through-route prescription analysis, would undermine the financial stability of many small railroads.

By the same token, proponents of the dramatic changes in regulation as set forth in their comments would have this Board reinvent and soften the ability of carriers to obtain forced competitive access over another railroad through the use of terminal trackage rights and reciprocal switching. As this Board is well aware, competitive access effectively compels a rail carrier to allow another railroad to enter the first railroad's line and literally "pirate" its business away. A more permissive use of competitive access remedies would have catastrophic impacts on the continued ability of small railroads to provide service. Permitting an adjoining railroad to "cherry-pick" the small railroads' largest customers, through the regulatory artifice of competitive access, would wholly undermine the small railroads' ability to serve the balance of their customers. These small railroads would face the loss of a significant proportion of their traffic on rail lines that were low-density and marginal to begin with. Ironically, in most cases, the traffic would be lost to the very Class I railroad that wanted to rid itself of the customer in the first place.

As the small railroad examples that I have previously discussed clearly illustrate, the small railroads work very hard through infrastructure and equipment investment, as well as service innovation and competitiveness, to build their customer shipments to a level where they are (ironically) attractive for this "pirating." It makes no sense to "punish" these small railroads for their investment by permitting the "cherry-picking" of their customers by another railroad, and foisting the high fixed costs of the small railroad onto the balance of customers on the line, all where there is no showing that the small railroad had market power, or abused the power which it did not possess in the first place.

Similarly, we do not believe that any change in the so-called "Bottleneck" rule is necessary to address pricing issues or exercises of market power concerning the small railroads. The current rule provides that rate reasonableness challenges must be brought against the rate for the entire origin-destination rail movement, rather than against rates for individual segments of the movement. For instances where a small railroad originates or terminates an interline shipment, that means that a rate complaint cannot be brought against the small railroad for only its portion of the movement, and there is no reason to believe that the ability to bring such complaints is necessary or warranted.

Small railroads simply do not have the ability to impose unreasonable pricing on segments where they may meet a technical definition of a "bottleneck" carrier. The lack of market power held by small railroads is aptly demonstrated by the virtual absence of rate complaints brought against those carriers at the Board.

Despite operating approximately one-third of the nation's rail system, small railroads earn barely five percent of national rail freight revenues. They handle competitive traffic over generally short distances, and face the widespread availability of intermodal and transload options. The reality is that much of the traffic handled by small railroads did not move on their rail lines in the past, and there is no guarantee it will in the future. Only attention to the customers' needs and competitive service has drawn traffic back to these often marginal rail lines, and the economics and financial reality of small railroads will require that such competitive attention and service continue in the future. Changes to the bottleneck rule, as applied to smaller railroads, are not needed to assure that result.

In the context of small railroads, the existing precedent and policy are also logical: they reflect the fact that the typical movements in which small railroads participate were

originally single-line Class I movements. The spinning off of lines to small railroads should not allow shippers to bring separate rate challenges against individual segments of an historically unitary route.

The small railroads have, by their very nature, provided a competitive rail alternative on light-density lines where the Class I's could not sustain the continuing viability of those lines. To enact a regulatory structure which would allow railroads to "cherry-pick" customers on the smaller railroads, or which allows customers to focus their rate challenges to the small railroad rate alone without regard to the fact that the small railroads are part of a larger rail movement, serves no valid purpose. We agree that this Board should protect the small railroads' customers from abuse of market power. The current regulatory structure is already in place to afford that precise opportunity.

Furthermore, we believe that, even if the draconian changes proposed by some very large shippers are adopted and imposed on the Class I railroads alone, that increase in regulation will have a severe and adverse impact upon small railroads. Such regulatory change is likely to reduce the Class I's willingness and ability to allocate resources and investments to assets serving the carload network, including lighter-density rail lines, yards, and cars dedicated to single-car or small unit train service, all of which are the lifeblood of the small railroad industry. By the same token, such reduction in investment would very likely result in reduced interchange frequency, increased car hire rates, additional accessorial charges, and a variety of other increased costs, all of which will further impact the small railroads' ability to compete in the marketplace and service their light-density lines.

To undermine the opportunity of small railroads to compete in the marketplace through the imposition of new regulations, without regard to any abuse of market power, will

undo all that has been accomplished in preserving the infrastructure, the service, and the jobs in large areas of the country associated with light density rail lines. That cannot be the result which Congress intended when it enacted Staggers and ICCTA.

ASLRRA continues to believe that the marketplace in which it operates does not need the intrusion of the regulatory changes proposed by the mega-shippers to function competitively and efficiently. The revitalization of a light-density rail line network in this country which began thirty-five years ago should not be cut off in the name of controlling market power that small railroads do not have. Congress plainly intended no such change when it adopted what is now the Board's governing statute, and this agency should be vigilant in assuring the continued viability of service to the customers and communities that rely on the nation's small railroads.

Our members' financial viability is not only dependent on their business acumen, but it is also dependent on the flexibility of the regulatory structure which enables them to react to the exigencies of an extremely competitive marketplace.

We appreciate the Board's consideration of our views on this matter.

BEFORE THE
SURFACE TRANSPORTATION BOARD

COMPETITION IN THE RAILROAD INDUSTRY	)	Docket No. EP 705

TESTIMONY OF SHARON CLARK
VICE PRESIDENT, TRANSPORTATION
PERDUE AGRIBUSINESS INCORPORATED

My name is Sharon Clark. I am the *Vice President Transportation* of *Perdue AgriBusiness Incorporated* ("Perdue") in Salisbury, MD. Perdue supports the position of the American Short Line and Regional Railroad Association in this proceeding regarding the state of competition in the railroad industry and the likely impacts of potential increased regulation on short line and regional railroads. Those railroads provide key transportation services to Perdue, and they do so in an efficient and price-competitive manner. The regulatory policies of the last thirty years have been an important component in the revitalization of the nation's rail transportation system, and have enabled short line carriers to maintain service on lines that otherwise would have been abandoned or downgraded. Changes in policies that do not preserve, protect and enhance short line rail service are inconsistent with supporting a vibrant agricultural industry and the broader public interest.

American agriculture supports a complex, integrated system of plant and animal production practices that satisfy human food needs, sustain the economic viability of farm operations, and enhance the quality of life for farmers and society as a whole. The U.S. is the breadbasket to the world, with U.S. farmers shipping more than $100 billion of their crops and products overseas. Farmers are a direct lifeline to more than 24 million U.S. jobs in all kinds of industries or approximately 17% of the total U.S. workforce. Today, the average U.S. farmer

feeds 155 people. In comparison, in 1960, the U.S. farmer fed just 26 people. Importantly, to keep up with population growth, farmers will have to produce more food in the next 50 years than was produced the past 10,000 years combined. The short line and regional railroad network which canvasses rural America, is imperative to U.S. agriculture.

Perdue is proud to be a part of American agriculture. Since its founding in 1920, The Perdue Companies have grown into the third largest poultry company and among the top 20 largest grain companies in North America. FPP Investments is our parent corporation – FPP stands for Franklin Parsons Perdue -- and we operate two businesses: Perdue Foods Incorporated and Perdue AgriBusiness Incorporated.

Perdue originates, trades and processes more than 250 million bushels of grains and oilseeds and more than 2 million tons of soy meal and feed ingredients annually, or the equivalent of 93,700 railcars of product each year.

These products support multiple businesses including grain, soybean crushing and refining, trading, rendering, blending and organic fertilizer with sales to both domestic and international customers in feed, pet food, food, fertilizer and renewable fuels industries.

Our Customer Promise is 'Helping customers prosper with flexible, forward-thinking solutions for agriculturally based products from a uniquely trusted name.'

Perdue operates more than 80 facilities, including 47 rail-served locations in 13 states. Of these 47 locations, 23 of them are served by 16 different short line or regional railroads. We use rail service to transport in excess of 60 different commodities and we shipped nearly 50,000 rail cars in the past year. Our market channels include export, domestic feed and food, processing and renewable fuels. Our short line partners provide flexible services for their shippers and receivers, ranging from pull-through power, on-demand switching, car storage, car

inspection and repairs, co-loading and unloading between facilities on the same line, weighing, track repairs and maintenance, and design and engineering.

We have built a transportation network which includes vessel, barge, truck and rail. Transportation is a critical component of our product pricing and customer service offerings. The availability of reasonably priced and accessible rail service is absolutely essential to the economic well-being and continued growth of our company, our customers, farmer partners, and the communities in which we operate. The rail services provided by our short line and regional carriers are responsible, reliable and price-competitive. We view our relationship with our short lines and regional railroads as a mutually productive and beneficial partnership. Perdue has benefited from the investments that our serving railroads have been able to make in their rail lines and equipment. Our short line partners have benefited from the investments in facility and track that Perdue has made. These investments have helped to generate the improved and efficient rail service on which we rely and have provided a platform for increased growth of rail traffic.

Perdue is acutely aware that things could be different, for us and for many other shippers who use short line and regional railroads. Before the start of the rail line spin-off movements in the 1980s, rail line abandonments, rail line embargoes and slow orders on lines were rampant across the country. Many shippers like Perdue faced the very real prospect that their facilities located on lighter-density lines would permanently lose rail service. We believe that the short line and regional railroad industry, and the regulatory regime that allowed it to flourish, are primarily responsible for this turnaround, and for saving rail service to many communities and shippers. Perdue has directly and significantly benefited from those revitalized

services. We would be concerned with any regulatory changes that would jeopardize the continuation of rail service by short lines and regionals over lighter-density lines.

At the same time, we are well aware of the challenges that short-line and regional railroads continue to face in operating lighter-density rail lines with high per-car fixed costs and potentially non-competitive traffic mixes. Recent regulatory initiatives that have a material impact on short line operations, and therefore the customer, include: the cost of investment to upgrade to 286,000 gross weight on rail; new Federal Railroad Administration rail bridge inspection and repair requirements; revised Federal Railroad Hours of Service rules; and Positive Train Control requirements. Another wave of abandonments is not inevitable, but it is a real possibility. Short line and regional railroads need to retain the financial strength and viability to make future investments in their lines, so that shippers like Perdue can continue to have access to the North American rail network.

In focusing on "competition" in the railroad industry, the Board cannot look past the more basic question of service availability. The short line and regional railroads that serve our facilities must compete effectively and continually for our business. We use rail service more extensively now than in the past because service has been competitive and efficient, but more importantly, fundamental market changes in the agricultural industry are changing the traditional sourcing locations and destination markets for many commodities. We do not see more government regulation of short lines and regional railroads as necessary to assure competitive and efficient rail service. We are more concerned that increased government regulation will have the opposite effect, undoing the hard-fought efforts of short line and regional railroads to revitalize moribund or declining rail lines and gain traffic that was moving by other modes.

Providing "competitive access" to two railroads for some interests cannot come at the expense of jeopardizing existing short line and regional railroad access for others. Rail lines that are viable under current short line ownership and existing regulatory policy could easily become something else if revenues are diverted from smaller carriers and investment in lighter-density lines is strangled. We do not wish to the return to the days when abandonment was the preferred option for branch lines, and we do not believe the Board wishes that, either.

We urge to the Board to consider the interests of small railroads carefully in this proceeding, and to assure that the critical role played by those railroads in the transportation system is not harmed.

We appreciate the Board's consideration of our views on this matter.

BEFORE THE
SURFACE TRANSPORTATION BOARD

COMPETITION IN THE RAILROAD INDUSTRY	)	Docket No. EP 705

TESTIMONY OF CARL D. MARTLAND, SENIOR RESEARCH ASSOCIATE AND LECTURER (RETIRED), MASSACHUSETTS INSTITUTE OF TECHNOLOGY

My name is Carl D. Martland. I have been actively involved in research concerning rail and freight operations and economics for more than 40 years. Before retiring from MIT in 2007, I was a Senior Research Associate and Lecturer in the Department of Civil and Environmental Engineering, where I was the director of the MIT Rail Group from 1978-2007 and the Program Manager of the Association of American Railroads Affiliated Laboratory at MIT from 1983-2001. I am now an independent consultant working with railroads and with public agencies on various matters related to railroad operations, railroad economics and competition within freight transportation systems. Over my career I have worked with all of the major North American railroads, many of the smaller railroads, and many government agencies on research related to rail service.

Because of my extensive background in rail research, I have had many opportunities to study costs, profitability, competitiveness and other major concerns facing Class I railroads, regional railroads, and short line railroads.

The ASLRRA asked me to address two questions. First, what are the special characteristics of the more than 500 short line and regional railroads that distinguish them from the Class I railroads? Second, how would these railroads, which I collectively refer to as small railroads, be affected by the changes in regulation that are being considered in EP 705?

Special Characteristics of Small Railroads

The railroads represented by ASLRRA are far different from the Class I railroads that serve thousands of customers over vast, complex, highly utilized networks. The small railroads cannot achieve economies of scale on their rail lines because their territories are small, their traffic densities are low, and they are primarily involved in the costly, switching-intensive portions of rail trips. As a result, fixed costs are by far the largest proportion of their total costs. Because of their size, they are dependent upon a limited, non-diversified traffic base. The three largest customers of typical small railroads account for two thirds of their total traffic, and their traffic base is dominated by general merchandise traffic that is susceptible to diversion to truck, intermodal, or water transportation; they have little or no role in coal, intermodal or automotive traffic that is so well-suited to rail transport and therefore so important to the Class Is.

Implications of Proposed Changes in Regulations

Because of their special characteristics, the small railroads face serious consequences in the event of changes in the regulations concerning access and routing. Allowing other railroads to access a small railroad's customers will not reduce the fixed costs of the small railroad's operation, but will divert traffic and reduce revenues. Since a high proportion of the small railroads' traffic mix consists of general merchandise traffic that is subject to diversion to other modes, small railroads have very limited pricing power. Given high fixed costs and limited pricing power, any significant loss of traffic volume or reduction in revenue will damage small railroads that are struggling to cover fixed costs and earn an acceptable return. Therefore, enabling other carriers to capture even one of their large customers would hurt even the healthiest of the small railroads. Likewise, regulatory actions that require small railroads to accept substantially lower revenue from one or more of their largest customers would similarly imperil

the carriers' ability to survive. Since many small railroads simply accept a share of the revenue received by the connecting Class I carrier, regulatory action that lowers the Class I carrier's revenue will also reduce the share received by the small railroad. Dividing low density operations among two carriers may reduce rates for one or two customers in the short run, but will certainly increase costs in the long run and threaten the ability of the small railroad to continue to serve all of its customers.

Analysis

My conclusions are based upon analysis of surveys conducted by ASLRRA and other information available concerning small railroads. I will elaborate on each conclusion in turn.

Average Costs are Very High for Small Railroads

For light density rail lines, fixed costs must be allocated to a small amount of traffic; total costs will therefore be well in excess of variable costs, and productivity will be low:

- The typical small railroad has 18 employees and achieves 1.5 million ton-miles per employee, which is just 15% of the productivity achieved by the Class Is.
- The average expenditures for equipment were $15.39 per 1000 RTM, more than twice as high as the average of $6.91 for the Class Is.
- The average expenditures for track were $4 per loaded car-mile for the small railroads, more than four times as high as the average of $0.83 for Class I railroads.
- Small railroads lack the volume to justify efficient, high volume yards, so they must use small yards with high fixed costs per car for maintenance and operation.

The detailed analysis in my V.S. also showed that the productivity declined as traffic volume declined; the smallest of the small railroads had the highest costs and the lowest productivity. A train requires a crew, even if there only are a few cars, and locomotives and track

must be maintained even if they are only used for short hauls. Wood ties deteriorate with or without traffic, while brush must be cleared, snow removed, and washouts filled in even if only a single train is to operate on a line. Because fixed costs are high for both operations and infrastructure, average costs for traffic handled by small railroads are highly dependent upon the volume of traffic that is handled.

Small Railroads Primarily Serve Truck-Competitive Traffic

The traffic base for small railroads is highly susceptible to diversion to truck. Few small railroads handle appreciable amounts of three commodity groups that are particularly well-suited to transportation by rail:

- Fewer than 8% of the approximately 550 smaller railroads handled any coal shipments at all, and three of these handled nearly half of the total.
- Only eight small railroads handled auto parts or new automobiles in 2010.
- Few small railroads handle intermodal traffic, almost all of which originates and terminates at facilities owned and operated by or for the Class I railroads.

While they have small amounts of coal, automotive and intermodal traffic, small railroads play a disproportionate role in what can be called general merchandise traffic, as they are involved in more than 40% of all rail shipments other than coal or intermodal. Since general merchandise traffic is highly truck competitive, actions that hinder the ability of small railroads to serve their customers will tend to divert traffic from the railways to highways.

Traffic handled by small railroads is also subject to diversion to other modes and other carriers. Most customers have good access to modern intermodal terminals and many have multiple options for using transfer terminals. If water transport is an option, most rail traffic is subject to competition from barges. In the most recent ASLRRA survey, small railroads without

any coal traffic indicated that close to 90% of their traffic is truck or barge competitive. If rail costs rise as a result of regulatory action, other transport options may become more attractive. Moreover, competition does not just involve modal competition for freight flows. Each customer competes with other companies who may use entirely different supply chains to produce similar products. If their logistics costs are too high, they may lose their business to other companies – and both they and their transport service providers will lose out.

Small Railroads Serve Customers Located on Light Density Lines

The territories served by small railroads are, by definition, much more limited than those of the Class Is. The average route-mileage is 99 and the median route-mileage is only 41. Only ten regional railroads operate over networks with more than 650 route-miles. The smaller railroads have made progress toward the goal of opening all of their lines to heavier cars, but this upgrading process is not yet complete; just over 60% of their route-mileage is open to equipment with gross vehicle weight of 286,000 pounds.

Although the smaller railroads collectively serve a great many customers, each individual smaller road has a traffic base dominated by a few customers and a few commodities. The average small railroad serves fewer than 25 customers. Typically, three of these customers account for two thirds of the carloads handled by a small railroad. A single commodity accounts for more than half of the traffic of the typical small railroad, whereas the top three commodities account for only 40% of the traffic of the Class Is.

With fewer route-miles, shorter hauls, and fewer customers, the smaller railroads have much less revenue than the Class Is. More than two thirds of the small railroads have revenues less than $10 million per year; nearly all have revenues less than $40 million per year. The median revenue per route-mile was $80 thousand per year, which is just 15% of the revenue

density of the Class Is ($510 thousand per route-mile per year). Unlike the Class I railroads, small railroads cannot use any contribution from efficient high-density main line operations to cover the fixed costs of their light density network.

Small Railroads Face Significantly Higher Average Costs of Rail Operations on Light Density Lines

It is the low volume of traffic and the high costs of serving customers – not the lack of competition – that limits the productivity of light density rail operations. The Class I railroads have been able to consolidate large volumes of traffic on their main lines as a result of major advances in track materials, locomotive reliability, signaling, and infrastructure investment. For operations over these high density mainlines, variable costs are low because trains can be long, heavy and operate at relatively high speeds due to the high quality of the track structure. Since these lines handle so much traffic, fixed costs can be allocated to a great many carloads and the average fixed cost per carload is very small. However, most general merchandise traffic originates within terminal areas or along light density lines where traffic volumes are much lower, train speeds are slower, and fixed costs are a much larger component of total costs. Similar observations can be made for switching costs. Switching costs are much higher for the small flat yards that typically serve local industries than for the large hump yards where the Class I railroads assemble most of their long-distance trains. In particular, the costs associated with track maintenance are one of the largest problems faced by small railroads, as these costs remain high even when traffic density is very low.

Small Railroads Must Cover High Fixed Costs Even If Traffic Is Diverted.

Any small railroad will have substantial fixed costs that must be covered, in the aggregate, by the revenue received from its customers. As long as the total fixed and variable costs can be covered, the railroad will be able to continue its operations. So long as a prospective

customer can cover those variable costs and make some contribution toward covering the fixed costs, that customer's traffic will add to the sustainability of the small railroad.

The opposite is also true. If a small railroad loses a customer, then it loses that customer's contribution and increases the share of fixed costs that must be covered by other customers. Since small railroads typically only have a few major customers, the loss of one of them would pose a very serious threat to the viability of that railroad.

The top three customers make up two-thirds of the traffic of the typical small railroad, and these are the large customers most likely to be targeted by a railroad or customer seeking competitive access. Given the high fixed costs that must be covered even after the revenue from a large customer is gone, the small railroad would face serious financial difficulties.

Summary

In this statement, I have shown that the operating conditions on light density lines lead to higher costs for labor, for track, and for equipment. Carriers operating under these conditions are already in a highly competitive situation, as nearly all of their traffic is subject to diversion to motor carriers, to an intermodal COFC/TOFC terminal operated by a Class I railroad, to a barge terminal, or to a competing transload facility. While operating costs and fixed costs are high, competition is severe, which means that margins are low. Where margins are low, loss of a major customer is very likely to push a small railroad toward cessation of operations or bankruptcy.

Allowing other railroads to access a small railroad's customers whether through forced terminal access or reciprocal switching will not reduce the fixed costs of the small railroad's operation, but will divert traffic and reduce revenues. As a result, the average rate required to cover fixed costs will rise, which would affect all customers on the line. Dividing low density

operations among two carriers may reduce rates for one or two customers in the short run, but will certainly increase costs in the long run and threaten the ability of the small railroad to continue to serve all of its customers.

Requiring lower rates - whether by reducing rates charged by small railroads or by reducing rates charged by Class I carriers that share revenues with small railroads – will damage the financial position of any small railroad that is struggling to cover fixed costs and earn an acceptable return to the owners. By the same token, permitting bottleneck or other rate complaint challenges which are limited to the small railroads' portion of the entire origin – destination route would yield results which are distorted and wholly inappropriate for application to the small railroads due to their disproportionately high fixed costs of operation and the fact that their costs are not embodied in URCS.

The traffic handled by small railroads is highly competitive traffic that is susceptible to diversion to other modes. Restricting the ability of small railroads to handle this traffic or increasing their costs of serving their customers is likely to have anti-competitive impacts, especially since small railroads have limited pricing power.

Legislation or regulations that allow open access or that limit small railroad revenues will hinder the ability of small railroads to handle time-sensitive, service-sensitive or price-sensitive traffic. Small railroads typically receive more than half of their revenue from their top two or three customers. Enabling other carriers to capture even one of these customers would severely hurt even the healthiest of the small railroads. Regulatory actions that require small railroads to accept substantially lower revenue from one or more of their largest customers would similarly imperil the small carriers' ability to survive.

Respectfully submitted,

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Dated: June 10, 2011